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No. 91-611

In The

Supreme Court of the United States

October Term, 1991

KEYTON BARKER and PAULINE BARKER, et al.,

Petitioners,

vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Kansas

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

The Kansas Income Tax Act provides that current compensation for current services received by federal military retirees is taxable whereas deferred compensation for prior service received by retired state and local government employees is not taxable. The question presented is whether this differential tax treatment is directly related to, and justified by, significant differences between federal military retirees and retired state and local government employees and is therefore consistent with 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity.

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RESPONDENTS' BRIEF IN OPPOSITION

Respondents respectfully request that this Court deny the petition for writ of certiorari seeking review of the opinion of the Kansas Supreme Court entered on July 12, 1991.

STATEMENT OF THE CASE

The basic facts in this case are stated in the opinion below and in the petition. There are additional relevant facts which merit mention.

First, the class of taxpayers represented by petitioners consists exclusively of retired members of the United States Armed Forces. The petition devotes considerable attention to the taxation of retirement benefits received by retirees of federal agencies such as the Public Health Service, the National Oceanic and Atmospheric Administration, the Central Intelligence Agency, the Foreign Service and the federal judiciary. Pet. 16-22. The petition also refers to these retirees as "the disfavored class," "disfavored federal retirees" and "disfavored government retirees." Pet. 18-22, 26-27. However, these retirees are not parties to this action and the taxation of their retirement benefits is not at issue.

Second, all members of the class of taxpayers represented by petitioners receive nondisability military retired pay which is taxable pursuant to the provisions of the Kansas Income Tax Act. However, Kansas does not tax all military retirement benefits. Military disability pay and Veterans Administration pensions are exempt from Kansas income tax. 38 U.S.C. § 3101(a), 26 U.S.C. § 104(a), Kan. Stat. Ann. 79-32,117 (1990 Supp.). It is only the taxation of nondisability military retired pay that is at issue in this case.

REASONS FOR DENYING THE WRIT

I. THE DECISION BELOW DOES NOT PRESENT A QUESTION OF SUFFICIENT IMPORTANCE TO WARRANT REVIEW ON WRIT OF CERTIORARI.

The question presented is naturally regarded as important by the particular parties involved. However, the decision below breaks no new ground and involves nothing more than a mechanical application of the principles an-

nounced by this Court in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), to a unique factual scenario. If this Court were to grant the petition for writ of certiorari, it could do little more than simply reiterate those same principles in the process of resolving what is essentially a parochial dispute.

Davis was a significant case and made important findings regarding the taxation of federal retirees. This case is a mere clone of *Davis*. This Court need not reexamine the issues arising in the field of intergovernmental tax immunity that were only so recently addressed. Nor does this case provide a suitable vehicle for this Court to remedy an unsettled area of the law or expand upon its previous pronouncements in a meaningful way.

Petitioners fail to cite a single state that has currently in place a statutory scheme similar to the challenged provisions of the Kansas Income Tax Act (KITA), Kan. Stat. Ann. § 79-3201 *et seq.* Accordingly, this is not a case of broad public significance and there are no "special and important reasons" why the petition for writ of certiorari should be granted. U.S. Sup. Ct. Rule 10.1.

II. THERE IS NO ACTUAL CONFLICT BETWEEN THE DECISION BELOW AND THE DECISIONS OF OTHER STATE COURTS OF LAST RESORT.

The decision below is alleged to conflict with decisions of the courts of last resort in Missouri, Arkansas and Colorado. However, even assuming there is a conflict, these three states have enacted legislation changing the manner in which they tax military retirees. Pet. 9 n.5. Similar legislation has been enacted in each of the states mentioned in the petition where issues regarding the taxation of mil-

itary retirees remain pending. *Id.* Thus, there is no "live" ongoing conflict which only this Court can resolve. Rather, the alleged conflict has already been resolved by legislative action in these other states.

The decision below does not conflict with the decision of the Missouri Supreme Court in *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. banc 1989), *cert. denied*, 110 S.Ct. 718 (1990). In *Hackman*, the State of Missouri conceded its method of taxing federal retirees, including military retirees, was unconstitutional. The only contested issue was whether federal retirees were entitled to receive refunds of taxes previously paid under an admittedly invalid tax scheme. The Missouri Supreme Court never considered whether the taxation of military retirement benefits was directly related to, and justified by, significant differences between military retirees and retired state and local government employees. Since the issue decided below was never considered in *Hackman* it is impossible to say that the two decisions are in conflict.

The decision below does not conflict with *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *petition for cert. filed*, 60 U.S.L.W. 3173 (U.S. Sept. 3, 1991) (No. 91-375), or *Kuhn v. Colorado*, ____ P.2d ____ (Nos. 90-SA-299 and 90-SA-300) (Colo. Sept. 16, 1991). The manner in which nondisability military retired pay (MRP) is taxed under the KITA is clearly distinguishable from the tax treatment of such income under the Arkansas and Colorado statutory schemes. Further, the rationale for differential tax treatment of MRP in Kansas is different than in Arkansas and Colorado.

Under the KITA, MRP is taxable whereas state and local government retirement benefits are exempt. Kan. Stat.

Ann. §§ 79-32,117 (1990 Supp.), 79-32,117(c)(ii) (1990 Supp.) and 74-4923(b) (1990 Supp.). The court below found that this differential tax treatment is justified because MRP is reduced current compensation for reduced current services while state and local government retirement benefits are deferred compensation. Pet. 30a.

The Arkansas statutes at issue in *Pledger* provided a $6,000 exemption for active duty military personnel but no corresponding exemption for current state and local government employees. Ark. Code Ann. § 26-51-306 (1987). However, state and local government retirement benefits were entirely exempt from tax while military retirees were limited to a $6,000 exemption. Ark. Code Ann. § 26-51-307 (1987). In its petition for writ of certiorari filed with this Court in *Pledger v. Bosnick*, No. 91-375, the State of Arkansas claimed its inconsistent tax treatment of MRP is justified by the favorable treatment of active duty military pay. Clearly, the Arkansas statutory scheme, and the justifications offered in support of its validity, is not comparable to the KITA and the reasoning of the court below.

The Colorado statutes at issue in *Kuhn* provided for equal tax treatment of all retirees, including military retirees, age 55 or older. Colo. Rev. Stat. § 39-22-104(4)(f) (1988 Supp.). However, military retirees under age 55 were limited to a $2,000 exemption while all other retirees received a $20,000 exemption. Colo. Rev. Stat. § 39-22-104(4)(g). The differential tax treatment of military retirees was clearly unrelated to any distinction between current compensation and deferred compensation. The only statutory basis to support different tax treatment was a retiree's age. This tax scheme, and its underlying rationale, is in no way similar to the taxation of MRP under the KITA.

Although the decision below is alleged to conflict with *Pledger* and *Kuhn*, nowhere do petitioners allege the KITA is identical, or even similar, to the statutory schemes previously in effect in Arkansas and Colorado. The facts and the law in those states are too dissimilar to conclude that the decisions are in conflict. All that can be fairly said is that each turns on its own set of circumstances when considered in light of unique statutory provisions.

These decisions do not conflict with respect to the interpretation and application of *Davis*, 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. Neither the Kansas Supreme Court nor any other state court of last resort has stated that *Davis* was incorrectly decided. There is no dispute that military retirees are entitled to receive the protection of 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. Further, there is no dispute that the test set out in *Davis* is applicable in determining the validity of differential state tax treatment of MRP. The only true point of conflict concerns the characterization of MRP as either current compensation for current services or deferred compensation for prior service. This is essentially a choice of law question.

Based on this Court's decisions in *United States v. Tyler*, 105 U.S. 244 (1881), and *McCarty v. McCarty*, 453 U.S. 210 (1981), the Kansas Supreme Court concluded that MRP is current compensation. [MRP is "reduced compensation for reduced, but currently rendered services." *McCarty*, 453 U.S. at 221. MRP is compensation "continued at a reduced rate and the connection (with the military service) is continued with a retirement from active service only." *Tyler*, 105 U.S. at 245.] In contrast, the courts of last resort in

Arkansas and Colorado opted to rely on state law characterizing MRP as deferred compensation or a pension.

The real question petitioners seek to have this Court decide is whether a state must ignore federal law characterizing MRP as current compensation and apply state law characterizing MRP as deferred compensation in determining the validity of a state tax alleged to violate principles of intergovernmental tax immunity. However, this Court's recent decision in *Mansell v. Mansell*, 490 U.S. 581 (1989), indicates that this question must be answered in the negative. *Mansell* stated that Congress may override the characterization of MRP as current compensation only by enacting a specific grant of authority giving states the power to treat MRP otherwise. 490 U.S. at 588. No such legislation has been enacted to permit states to deviate from the federal characterization of MRP for state income tax purposes. This Court should not grant the petition for writ of certiorari unless it intends to reconsider or overrule *Mansell*.

The other grounds of conflict alleged by petitioners are either speculative or illusory. Petitioners urge this Court to ensure the taxation of military retirees will not vary from state to state. Pet. 8. However, states clearly have the authority to either tax, or not tax, military retirees. They are prohibited only from a tax that discriminates against military retirees because of the source of their compensation. 4 U.S.C. § 111. One state may elect to tax all retirees while another state may exempt all retirees. MRP would be subject to tax in the first state but not in the second. But this would not constitute a violation of the law by either state. The alleged conflict is not one the law was designed to prohibit.

Petitioners also allege that, if allowed to stand, the decision below will encourage other states to tax military retirees. Pet. 9-10. Again, states have the authority to impose such a tax and whether a state legislature may elect to do so at some future time is irrelevant to this Court's consideration of a petition for writ of certiorari.

III. THE TAXATION OF MILITARY RETIREMENT BENEFITS UNDER THE KANSAS INCOME TAX ACT IS CONSISTENT WITH THIS COURT'S HOLDING AND RATIONALE IN *DAVIS V. MICHIGAN DEPT. OF TREASURY*, 489 U.S. 803 (1989).

The taxation of MRP under the KITA does not conflict with the narrow holding in *Davis* or the broader principles discussed therein. *Davis* involved federal civil service retirees, not military retirees. This Court held that a state is prohibited from taxing federal civil service retirement benefits if it does not also tax state and local government retirement benefits. In Kansas, both federal civil service retirement benefits and state and local government retirement benefits are exempt from tax. Kan. Stat. Ann. §§ 79-32,117(c)(vii) (1990 Supp.), 79-32,117(c)(ii) (1990 Supp.) and 79-4923(b) (1990 Supp.). Thus, the KITA does not suffer from the same infirmities that caused the Michigan tax at issue in *Davis* to be declared unconstitutional. Further, the KITA exemption for federal civil service retirement benefits is significant in determining the validity of the differential tax treatment of MRP.

The source of both federal civil service retirement benefits and MRP is the federal government. The fact that federal civil service retirement benefits are exempt while MRP is taxable belies petitioners' claim that MRP is taxable

because of its source. Since other income from the same source is exempt the basis for the taxation of MRP must rest elsewhere. As the court below stated, "[t]he fact that KITA exempts federal civil service retirement benefits and federal railroad retirement benefits is further evidence that the KITA taxation of federal military retirement benefits is not based on the federal government source." Pet. 28a.

Under *Davis*, a state tax which discriminates against federal retirees does not, in and of itself, violate 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. Differential treatment of federal retirees and retired state and local government employees is permissible if "there are 'significant differences between the two classes' themselves." *Davis*, 489 U.S. at 816. The only prohibition is that the tax may not discriminate "because of the source of pay or compensation." 4 U.S.C. § 111.

The two classes of taxpayers considered in *Davis* were essentially alike. Where there are no significant differences between two classes of taxpayers, a discriminatory tax can only be deemed to differentiate on account of some extrinsic factor such as the source of income. It was for this reason the Michigan tax was declared unconstitutional. However, a discriminatory tax can be justified if it is based on intrinsic differences. Nothing in 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity prohibits different tax treatment of two classes of taxpayers that are inherently different.

While this Court's analysis in *Davis* disclosed no significant differences between the two classes of taxpayers, the court below identified numerous differences between military retirees and retired state and local government employees. Foremost among these is the fact that military

retirees receive reduced current compensation for reduced current services while retired state and local government employees receive deferred compensation for prior service. Pet. 30a. Consistent with this finding, this Court has stated that MRP "*differs in some significant respects* from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221. (Emphasis added). Similarly, the Department of Defense has stated that, despite a superficial resemblance, "there are in fact *substantial differences* between the military retirement system and all other retirement systems." *Military Compensation Background Papers—Compensation Elements and Related Manpower Cost Items—Their Purposes and Legislative Backgrounds*, 3rd Ed. (1987) 367-368. (Emphasis added).

Respondents do not dispute the result in *Davis*. If Kansas, like Michigan, taxed federal civil service retirement benefits while exempting state and local government retirement benefits such a tax would clearly be unconstitutional. However, the facts in this case are distinguishable from those in *Davis* and compel a different result. The two decisions are not in conflict.

In *Davis*, this Court set out the test for determining the validity of a state income tax alleged to violate the doctrine of intergovernmental tax immunity. "[T]he relevant inquiry is whether the inconsistent tax treatment is *directly related to, and justified by,* 'significant differences between the two classes.' " *Davis*, 489 U.S. at 816. (Emphasis added). The court below concluded that the taxation of MRP under the KITA satisfies both prongs of the *Davis* test.

As discussed above, the Kansas Supreme Court determined the differential tax treatment at issue is "justified by" the distinction between current compensation and de-

ferred compensation. Petitioners have made no attempt to discredit the grounds relied upon in the court below. Petitioners simply ignore *Tyler* and *McCarty*. They do not suggest those decisions are distinguishable, inapplicable or should be overruled.

Instead, petitioners argue military retirees are entitled to the same tax treatment as all other federal, state and local government retirees because 4 U.S.C. § 111 does not recognize any distinction between federal officers and employees. Pet. 28. This view, however, exposes petitioners' misapprehension of the nature and purpose of 4 U.S.C. § 111. It is correct that all federal retirees, including military retirees, are entitled to the protection of 4 U.S.C. § 111. However, all federal retirees are not alike and 4 U.S.C. § 111 does not require that they all be taxed in the same manner. Had Congress intended such a result the statute would contain words to that effect. The purpose of 4 U.S.C. § 111 is to prohibit discrimination against the federal government and those with whom it deals. *Davis*, 489 U.S. at 812. (Citations omitted). This is achieved by requiring that federal retirees receive the same tax treatment as other similarly situated taxpayers, not by erecting a *per se* prohibition against nonuniform taxation of federal retirees. Since "military retirement benefits are unique in comparison to other federal retirement benefits," (Pet. 29a) there is no merit to petitioners' claim that military retirees and other federal, state and local government employees are similarly situated and that MRP is taxed solely on the basis of its federal source. In fact, the taxation of MRP is "justified by" its unique character as current compensation for current services.

This Court's analysis in *Davis* was also the basis for the conclusion in the court below that the taxation of MRP is "directly related to" significant differences between military retirees and retired state and local government employees. In *Davis*, the State of Michigan claimed the differential taxation at issue was designed to tax large pensions and exempt small pensions. However, the purported differences between the two classes of taxpayers did not hold true in all instances. Certain exempt state and local government pensions were larger than certain taxable federal pensions. Hence, the differential tax treatment was not "directly related to" the alleged differences. An "evenhanded application of the rationale" for taxing federal pensions would have resulted in the taxation of some state pensions. *Davis*, 489 U.S. at 817, citing *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 384-385 (1960).

Utilizing this same reasoning, the court below found that the differences between the two classes, those receiving federal military retirement benefits and those receiving state and local government retirement benefits, "are common to all members of each class." Thus, "an evenhanded application of the rationale" for taxing military retirees does not result in the taxation of some state and local government retirees. Pet. 28a. This analysis is consistent in every respect with this Court's analysis in *Davis*.

Petitioners allege the court below erred by failing to consider the effect of the KITA on certain federal retirees, other than military retirees, who are not parties to this action. There is nothing in *Davis* to indicate this is a proper method of analysis. This Court in *Davis* did not examine the interests and characteristics of other federal retirees to

determine the validity of the Michigan tax on federal civil service retirees. In essence, petitioners urge this Court to modify the test set out in *Davis*. This runs counter to their claim that the decision below conflicts with *Davis* and demonstrates that it is petitioners, not respondents or the court below, who would have this Court depart from its previously stated approach.

Further, since military retirees are unique in comparison to other federal retirees, the validity of the tax on MRP cannot be determined by the manner in which other federal retirement benefits are taxed. The Kansas Supreme Court rejected petitioners' bootstrap argument that military retirees are similarly situated with all other federal retirees and refused to issue an advisory opinion as to the validity of the taxation of other federal retirement benefits under the KITA. This Court should likewise refrain from addressing an issue that is beyond the scope of the pleadings and not fairly embraced in the question presented.

CONCLUSION

This Court's decision in *Davis* prompted a flood of litigation. Challenges were brought in state courts across the country to test the validity of various tax schemes providing for differential tax treatment of federal retirees. The decision below is only one such case. Having clearly articulated the legal standard for determining the validity of a state tax alleged to violate principles of intergovernmental tax immunity, this Court has fully and adequately addressed this area of the substantive law. It simply cannot review every decision in which the *Davis* test is construed and applied.

The decision below is particularly unsuitable for review on writ of certiorari in light of the narrow question presented. In the aftermath of *Davis*, most states have overlooked or ignored the taxation of military retirees. The question presented is widely regarded as unimportant and of only minor significance. The only question arising out of the *Davis* decision that remains unsettled and merits this Court's attention is whether *Davis* applies prospectively or retroactively. That question is not presented herein.

The decision below is not only correct, it is consistent in all respects with this Court's analysis in *Davis* and prior decisions of this Court stating that MRP is current compensation for current services. Any conflict with decisions of other state courts of last resort goes only to the choice of law issue and is further mitigated by the intervening legislative action in those other states and the unique manner in which each state taxes MRP. It is respectfully submitted that the petition for writ of certiorari should be denied.

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